The year 2010 is approaching and the Lisbon strategy will have to be replaced by a new strategy. The Foreign Ministry has asked the National Board of Trade to discuss ideas for external commercial policies to support the reforms carried out domestically to increase growth. This can be called an "external dimension" of a new strategy. For this purpose we have written eight reports, covering a range of areas, and a summary. You can find it all at www.kommers.se/trade&growth

Foreign direct investments are determinants for economic development **and further instruments and key components to sustain and further improve the competitiveness of the EU. This is based on research which concludes that foreign direct investments generate economic benefits for the receiving host economy, as well as for the sending source economy.**

The current regulation of investments in the EU **is heterogeneous and contains several discrepancies which originate from the division of competence between the EU member states and the EC. This has resulted in different levels of protection for EU investors abroad (legal as well as financial) and moreover a non-transparent patchwork of EU member states BITs. The division of competence has also led to that the regulation of capital movements varies from member state to member state, resulting in discrepancies. Thus, the current situation prevents the EU from negotiating broad and in-depth investment agreements with its trading partners. This harms the EU as a whole as it creates distortions between EU member states and moreover reduces the market access for EU investors in third countries.**

We propose a common investment policy for the EU **which should include EU competence to negotiate international investment agreements covering both market access and investment protection. It would also include harmonization, at a lower level, of the EU member states' restrictions on capital movements. This would improve the competitiveness of the EU as a whole through increased transparency and reduced asymmetries. In effect, a common investment policy would first, strengthen the market access and investment protection in third countries for EU investors and second, create an equal level playing field for foreign investors in the EU. Thus, it would strengthen the EU on the global arena, as it would increase the EU´s possibilities to conclude broad and in-depth international investment agreements.**

***At the international level*, investments are today regulated through both multilateral instruments and numerous bilateral and regional agreements, which have grown considerably during the last decade. These agreements create a patchwork, which brings about discrepancies and uncertainties. This is suboptimal. *Therefore, a global investment agreement would be desirable in the future*. The thought of a global investment agreement, aiming to create a transparent, predictable, stable and non-discriminatory global investment climate, is not new. In the past, several initiatives have been taken to reach such an agreement. However, the reasons for a multilateral framework remain, by and large, the same. It can even be argued that against the background of the increasing number of regional and bilateral investment agreements and thereto related investment disputes, the reasons will be even stronger in the future.**

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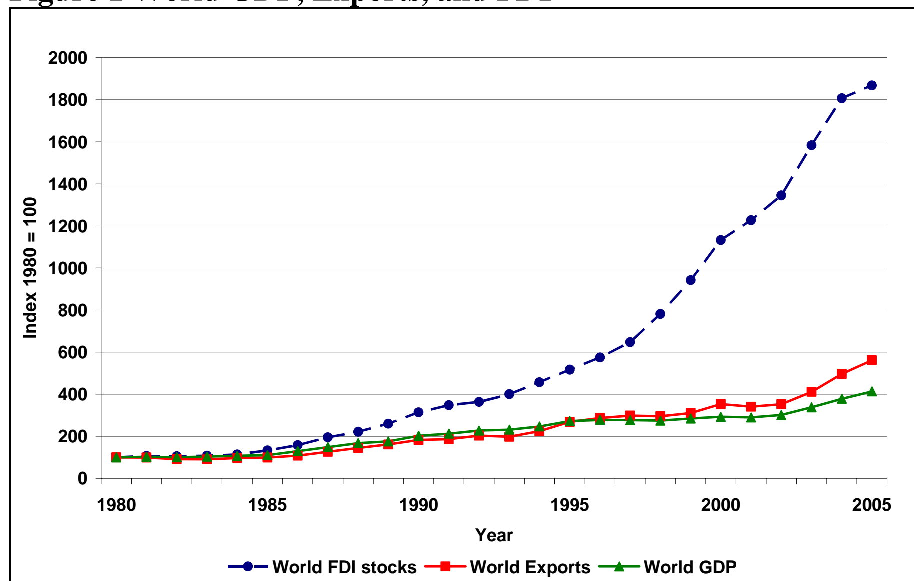
1 Foreign Direct Investments and Increased competitiveness

In the last decades of globalization, there has been a substantial growth in world income and world trade. Still, as illustrated in Figure 1, one of the most striking features in the globalization process is the rise in foreign direct investment (FDI) by multinational enterprises (MNEs), which has grown faster than both trade and production, indicating that not only trade but also international investments and production drives the globalization. Over the period 1980 to 2005, FDI increased 18 times over its initial value, while merchandise trade and domestic production, respectively, increased 6 times and 4 times.

Figure 1 World GDP, Exports, and FDI



Source: World Development Indicators
Note: Index numbers, 1980=100

One of the most interesting features about FDI is that it not only enables firms to deliver goods and services to foreign markets, but also can be used as a tool to coordinate production and sales schemes between countries. Nowadays, an increasing number of MNEs are pursuing several integration strategies, encompassing different features. [1]

[1] Economic research typically distinguishes between "*horizontal*" market seeking FDI, in which the MNE duplicates the production (mostly to developed countries) and produces similar products or services in multiple locations, and "*vertical*" cost reducing FDI, in which the MNE fragments the production process internationally and locates the production (mostly to low-cost countries) where it can be done at the least cost. See for instance, Markusen (1984, 1997, 2002), Horstmann and Markusen (1992), Markusen and Venables (1998, 2000) and Helpman (1984, 1985)

Today there are 77.000 MNEs world wide, with around 770.000 affiliates in foreign countries, which are thus important in the globalization process, as they represent the greater part of the international trade and investments flows and further encompass great resources in technology and manpower skills.[2]

1.1 Linking FDI to Competitiveness

In this section we will assess the impact of FDI coming to the EU (denoted inward FDI) and FDI moving out from the EU (denoted outward FDI) on the EU economy.

From an economic standpoint, questions concerning FDI mostly relate to (i) whether inward FDI and the presence of foreign MNEs generate welfare improvements for the receiving host economy, and (ii) whether outward FDI benefit and contribute to the overall performance of the remaining MNE activities in the sending home economy,

FDI as an instrument for economic development and economic growth is complex. One can with ease state that it is difficult to map the effects from FDI as they occur through numerous direct and indirect channels and further depend on the specific nature of the FDI and the explicit characteristics of the countries sending and receiving the FDI.[3] A key issue in this matter concerns the question of what would have happened in the absence of the FDI.

Even though the FDI also comprises political and social consequences, the following sections mainly focus on the economic effects.

1.1.1 Inward FDI Effects: Why is it Important to Attract FDI to the EU?

The attitude towards inward FDI has changed significantly during the last decades, as countries around the world have begun to realize the positive aspects of FDI and now actively seek inward FDI.

The overall benefits of inward FDI for host economies are well established. The majority of the economic research concludes that FDI generates economic growth, both direct and indirect, by raising the total factor productivity and by optimizing the allocation of resources in the host country economy, given that the receiving host country has a well functioning absorption capacity, and reached a certain level of development in education, technology and infrastructure.[4]

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[2] UNCTAD (2006).

[3] Barba-Navaretti and Venables (2004) categorize the FDI effects into three groups, "*product market effects*", which relates to the changes in goods and services, sold and bought in the home and the host country, "*factor market effects*", which relates to the changes on the capital and labor markets, and "*spillover effects*", which relates to the technological spillover externalities and sourcing effects coming from FDI.

[4] For instance, Blomström et. al. (1994) and Xu (2000) show that FDI and the presence of MNEs have a positive and significant impact on the GDP per capita and the total

The existing literature on FDI points to three major channels through which FDI improve the efficiency and the competitiveness in the host country. These are (i) transfers of technology and beneficial spillover externalities, (ii) structural endowments facilitating a more competitive business environment, (iii) international trade.

The most important channel, in which FDI and the presence of MNEs positively contribute to the host economy, is through the transfers of technology and beneficial spillovers.[5] This relates to the fact that MNEs, compared to domestic firms, are more efficient and more productive, pay higher wages, employ more highly skilled personnel, and further generally possess a higher level of technology and more efficient operational and management procedures than is available in host country.[6]

In detail, the technology transfer and external diffusion can be channeled into the host economy through (i) vertical linkages where MNEs support local firms, within the MNEs network, in facilitating an upgrading of the production system, which improves the economic efficiency of the firms, (ii) horizontal linkages where new technology and new working practices spill over to domestic firms, outside the MNEs network, (iii) training and migration of skilled labor, (iv) increased R&D and other innovative activities. [7] These channels are all relevant to further enhance the competitiveness of the economy.

Moving on to the structural endowments in the host economy, FDI and the presence of MNEs significantly promote economic growth and development by creating a more efficient and a more competitive business climate which facilitates higher productivity, create a more efficient allocation of resources, promotes domestic enterprise growth and yields lower prices.

Turning to international trade, inward FDI further integrates the host economy and its domestic firms more closely into the world economy, which helps the host economy and its firms to expand internationally and utilize the benefits from globalization.[8] More explicitly, FDI and MNEs increase the competition in the host economy which stimulates domestic firms to become more productive and expand through export.[9]

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factor productivity in the host country, which is in accordance with Markusen and Venables (1999), and Haaland Wooton (1999) who argue that FDI can work as a catalyst for development with accompanying welfare gains in the host economy.

[5] A detailed picture of spillovers effects from FDI can be found in Blomström and Kokko (1998).

[6] See Helpman, Melitz and Yeaple (2004) and Navaretti and Castellani (2003).

[7] Even though it is commonly accepted that technology and knowledge can be transferred to local firms that are connected to the MNEs, the empirical research can not conclude whether these benefits spill over to the rest of the host economy. It is further relevant to recognize that training provided by MNEs through FDI can complement but not replace the public education.

[8] See Görg and Greenaway (2004).

[9] Blomström and Kokko (1998) and Balasubramanyam et. al. (1996).

In sum, the main policy conclusion is that FDI generate economic benefits for the receiving host country, which at a whole contributes to higher host country competitiveness. Hence, FDI can ultimately be seen as a catalyst strengthening the recipient host country economy.

1.1.2 Outward FDI Effects: Enhanced Competitiveness for the EU

The summarized research in this field concludes that outward FDI generates positive and beneficial effects to the home economy, as the outward FDI allows MNEs to reap the benefits coming from globalization through production fragmentation, economies of scale and global sourcing for knowledge. This increases the MNEs profit, improves the average performance and utterly enriches the domestic production, beneficial for the competitiveness of the home country.

More explicitly, the majority of the research concludes that activities by MNEs on foreign markets, in terms of production, employment and trade do not substitute for domestic activities, in the long run. On the contrary, research concludes that FDI positively raise the productivity growth and output in the home country.[10] Moreover, the majority of the research that have assessed the effects of outward FDI on home country exports, conclude that the complementarities tended to outweigh the substitution effects. [11]

In detail, the research indicate, in the short run, that certain added-value activities, previously carried out at home, can be re-allocated to foreign countries, implying small job losses[12] However, the short-term negative impact of outward FDI on employment in the home economy is small, and, in the long term scenario, there are overall gains to the host country. Outward investing MNEs gain market access, increase their productivity and expand their activities, which is beneficial for the home country competitiveness.

In this context, it is vital to recognize that MNEs need to continuously restructure their entities in order to improve their competitiveness, through both market- and efficiency-seeking FDI. That is, in the context of an open market economy, improved competitiveness for the MNE is much needed to grow and adapt in the external environment and further achieve strategic objectives, such as expanding market access beyond their national borders, enhancing efficiency and acquiring strategic re-

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[10] Navaretti and Castellani (2004).

[11] See Horst (1974), Bergsten, Horst, and Moran (1978), Kravis and Lipsey (1988), and Lipsey and Weiss (1981 and 1984), Brainard (1997) for studies on US, Swedenborg (1979, 1982, 1985, and 2001), Blomström, Lipsey, and Kulchycky (1988), and Svensson (1996) for studies on Sweden, Lipsey, Ramstetter and Blomström 2000a, 2000b) for Japan, and Fontagné and Pajot (2002) for France.

[12] This may yield a conflict of interest between MNEs incentives in maximizing profits through firm restructuring and utilizing capital and labor resources within the global corporate network, and home government preferences in preventing a possible “hollowing out” of the domestic production base, which would cause structural adjustments and social costs.

sources and assets in order to maximize profits. There is also evidence that knowledge souring FDI promotes a technology upgrading on the home activates, since MNEs acquire foreign technological knowledge from the abroad affiliates. This fact relates to the evidence which show that firms that are engaged in foreign activities, comprising FDI, are more productive than national firms which only operate in the home country.

In sum, it is beneficial for the home economy if domestic firms start to invest in other countries and become multinational, as it improves the competitiveness of the home based MNEs. This is a key issue for policymakers since it generates broad economic benefits and utterly enhances the home country competitiveness.

2 The Regulation of Investments – in the EU and Internationally

This section describes the regulation of investments in the EU. When the Lisbon Treaty amending the Treaty on European Union and the Treaty establishing the European Community (Lisbon Treaty) comes into force, the EU will gain more competence in the investment area. Consequently, this section on the regulation of investment in the EU has been divided into two parts: current and future regulation. This section also describes the multilateral, regional and bilateral investment instruments which are regulating investment at the international level. In addition, the section describes the work of international organizations that are influencing the regulation of investments. In sum, the section provides an overview of the various treaties, instruments and organizations that are regulating investments.

2.1 The Current Regulation of Investments in the EU

2.1.1 The Right of Establishment on the Internal Market

Article 43 of the Treaty Establishing the European Community (EC Treaty) provides for the *freedom of establishment within the internal market*. This implies the right for EU citizens to take up and pursue activities as self-employed persons and to set up and manage undertakings under the same conditions as laid down by the law of the member state of establishment (the host state) for its own nationals. Furthermore, under Article 48 of the EC Treaty, companies or firms formed in accordance with the law of a member state and having their registered office, central administration or principal place of business within the EU, are to be treated in the same way as natural persons who are nationals of member states. This applies to legal persons from third countries, as long as they are formed in accordance with the law of an EU member state. The freedom of establishment goes beyond prohibiting discrimination. It also requires the removal of any unjustified barrier to establishment.

Restrictions of the freedom of establishment can be justified in the following cases:

- Discriminatory measures
    - The exercise of official authority (Article 45 of the EC Treaty)
    - Public policy, public security and public health (Article 46 of the EC Treaty)
- Non-discriminatory measures – according to case law from the European Court of Justice national measures that hinder the freedom of establishment must fulfill the following four conditions:

- They must be applied in a non-discriminatory manner
- They must be justified by imperative requirements in the general interest
- They must be suitable for securing the attainment of the objective which they pursue
- They must not go beyond what is necessary in order to attain it (principle of proportionality)[13]

2.1.2 The Freedom of Capital Movement: on the Internal Market and Between EU Member States and Third Countries

Article 56(1) of the EC Treaty prohibits restrictions on *capital movements – including direct investments, investments in real estate, portfolio investments*[14] -, between EU member states and between EU member states and third countries. The prohibition is, however, not absolute. Articles 57-60 of the EC Treaty provide for specific exceptions to the freedom of capital movements and Articles 295-296[15] provide for general exceptions of the Treaty. In this context, Articles 57(1), 57(2) and 58 of the EC treaty is deemed to be of most interest.

Firstly, according to Article 57(1) of the EC Treaty, the prohibition does not apply to restrictions on *direct investment*[16] which existed on 31 December 1993.[17] The exception covers both restrictions by the EU member states and by the EC itself.

Secondly, according to Article 57(2) of the EC treaty, the Council can adopt measures on the movement of capital to and from third countries (including restriction on capital movements). This gives the EU competence to adopt both internal EU legislation and to conclude international agreements with third countries.

Thirdly, Article 58(1) provides for exemptions justified on grounds of public order or public security, for tax administrative reasons and needs of prudential supervision of financial institutions.

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[13] Case C-19/92 Dieter Kraus v Land Baden-Wuerttemberg, para 32. For an extensive explanation of the ECJ's case-law relating to Article 43, see European Commission, Guide to the case law of the European Court of Justice on Article 43 et seq. EC Treaty – Freedom of establishment (2001). See also Communication from the European Commission on Certain Legal Aspects on intra-EU investment (1997).

[14] For a list of transactions that are to be considered as capital movements, see Annex I of Council Directive 88/361/EEC, p.5. It is settled case law that the Directive and Annex I may be used for the purposes of defining what constitutes capital movements, see Case C-222/97 Trummer and Mayer, paras. 20 and 21.

[15] Article 295 contains restrictions on property ownership, while Article 296 provides for exceptions for national security and defense.

[16] Direct investment includes investments in real estate, establishment, the provision of financial services and the admission of securities to capital markets.

[17] For Bulgaria, Estonia and Hungry, the date shall be 31 December 1999.

In the absence of secondary legislation, guidance for the interpretation of the articles in the EC Treaty can be found by ECJ jurisprudence. For example, purely economic reasons do not serve as a justification for imposing restrictions (e.g. choosing a strategic partner, structural considerations, fostering modernization of the sector).[18] Public order and public security as justifications for FDI restrictions have to be interpreted narrowly. They can be invoked only if there is a genuine and sufficiently serious threat to a fundamental interest of society.[19] In addition, all FDI restrictions may not go beyond what is necessary in order to achieve their objective and must prove impossible to achieve their objective by less restrictive measures (principle of proportionality).

2.1.3 Investment Restrictions Maintained by EU Member States

The level and nature of investment restrictions vary from country to country within the EU. As explained above, the EU member states may keep restrictions to capital movement which existed on 31 December 1993. In addition, member states may adopt new measures justified under the EC Treaty. For example, Germany is in its way to adopt legislation establishing an inter-ministerial commission to review, and possibly veto, acquisitions by a foreign owner (threshold: 25 % voting stake) it deems to pose a threat to national security or public order.[20] Likewise, Greece is adopting new legislation for companies of national strategic importance. Under the new Greek legislation, acquisition of voting rights (20 % of the share capital or more) in such companies will require the approval of an inter-ministerial privatizations committee.[21]

To illustrate the current levels of restrictions on inward FDI, we present OECD's FDI Regulatory Restrictiveness Index for 29 OECD member states and 14 OECD non-member states, depicted in Figure 2.

The index covers three types of restrictions; (i) *equity* - limitations on foreign ownership, (ii) *screening* - screening or notification procedures (e.g. review of foreign acquisitions), and (iii) *operational* - management and operational restrictions (movement of key personnel), and is measured on scale from 0 to 1, in which 0 represent full openness and 1 represent FDI prohibition.

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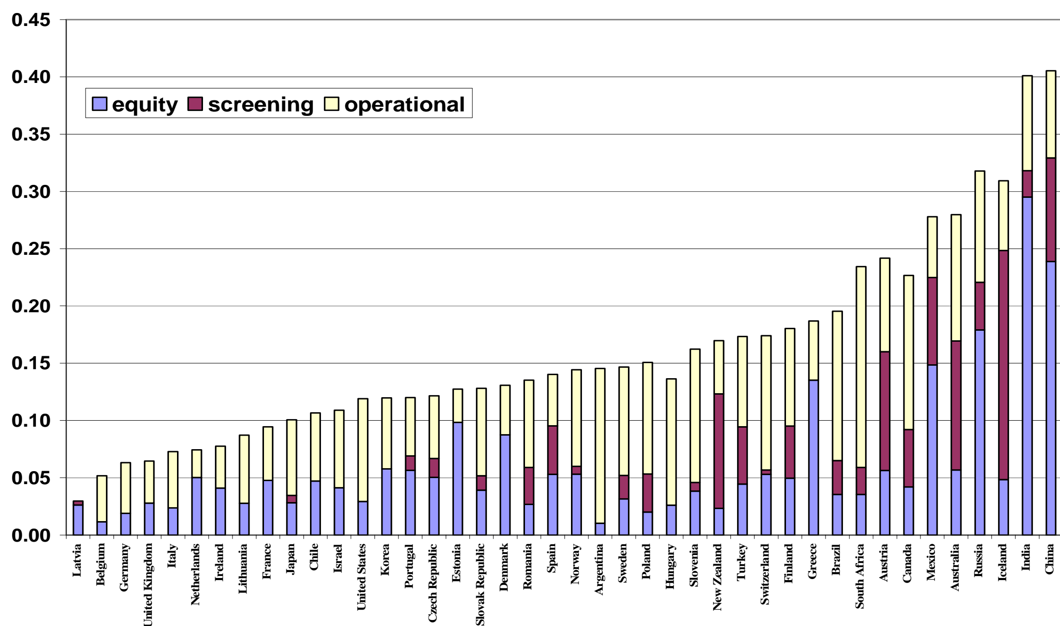
[18] See C-367/98 Commission v. Portugal.
[19] See in particular C-54/99 Association Eglise de Scientologie de Paris.
[20] See OECD (2007a).
[21] See OECD (2007b).

The index clearly shows that the EU is not harmonized in terms of policies towards inward FDI. We can also see that the most open countries towards inward FDI can be found in Europe and the most restrictive countries can be found outside EU. All the four largest EU economies receive a score on the index below 0.1, which implies very low restrictions to FDI. None of the EU member states score worse than 0.25. Nevertheless, considering the sums of money involved, even small restrictions can have a big impact.

Figure 2 FDI Regulatory Restrictiveness by Type of Restriction



Source: OECD (2006)
Note: *Equity* - limitations on foreign ownership, s*creening* - screening or notification procedures (e.g. review of foreign acquisitions), *operational* - management and operational restrictions (movement of key personnel),
Note: The FDI restrictiveness index encompasses 9 sectors and 11 sub-sectors, Business (legal, accounting, architectural, and engineering services), Telecommunications (fixed-line telephony and mobile telephony), Construction, Distribution, Finance (insurance and banking), Tourism, Transport (air transport, maritime transport and road transport), Electricity and Manufacturing.

2.2 The Future Regulation of Investment in the EU – the Lisbon Treaty[22]

With the entry into force of the Lisbon Treaty, FDI will be included in the Common Commercial Policy for which the European Union will have exclusive competence.[23] The Lisbon Treaty will come into force at the earliest on 1 January 2009.

At present, the EC and the member states have shared competence for investments, apart from investment protection and promotion which is member state competence. Thus, the entry into force of the Lisbon Treaty will change the current division of competence.

The Lisbon Treaty does not define the term ”Foreign Direct Investment”. There is also no common definition of FDI at the level of individual EU member states. However, guidance could be found in the OECD Code on the Liberalisation of Capital Movements. The code defines "direct investment" as "*investment for the purpose of establishing lasting economic relations with an undertaking such as, in particular, investments which give the possibility of exercising an effective influence on the management thereof*". The definition covers:

- The creation or extension of a wholly-owned enterprise, subsidiary or branch, and acquisition of full ownership of an existing enterprise;
- Participation in a new or existing enterprise; and
- A loan of five years or longer.[24]

This definition of FDI provides some guidance for the coverage of the common commercial policy in the Lisbon Treaty. For example, it is clear that portfolio investments (i.e. short term investments) will not be covered by the Common Commercial Policy. Still, it is not clear how far the Common Commercial Policy will reach.

A wide interpretation of Article 188C of the Lisbon Treaty would include both pre- and post-establishment phase in the EU's exclusive competence.[25] Thus, conclusion of bilateral investment agreements would become EU exclusive competence. A narrow interpretation (limiting the competence to post-establishment issues) would, on the other hand, in

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[22] FDI was included in the common commercial policy in the Treaty Establishing a Constitution for Europe (Article III-315). For an in-depth discussion of EU competence on FDI, see Karl J. (2004).
[23] Article 188C of the Lisbon Treaty.
[24] See Annex A, item I of the Code on the Liberalisation of Capital Movements. Annex I of Council Directive 88/361/EEC, p.5 provides a similar definition of direct investment.
[25] The pre-establishment phase includes issues linked to market access. The post-establishment phase encompasses protection of establishment, such as compensation for expropriation, fair and equitable treatment and settlement of disputes.

substance merely reflect the current division of competence as laid out in Article 56 and 57 of the EC Treaty.

It is also possible that the common commercial policy would include investment guarantees and investment incentives, as they are means to promote FDI abroad, respectively, attract FDI from abroad.

As FDI is closely linked to other policy areas (e.g. taxation and labor policy) it would be possible to transfer competence in these areas through competence on FDI. In order to prevent this, Article 188C(6) of the Lisbon Treaty provides that the exercise of competence through this article does not affect the division of competence elsewhere in the Treaty unless explicitly stated.

2.3 International Investment Rules

2.3.1 Multilateral Initiatives

There is no multilateral investment agreement. Certain investment issues are, however, regulated through multilateral instruments. To start with, a number of WTO agreements have bearing upon investments. The most important agreements are: the General Agreement on Trade in Services (GATS); the Agreement on Trade-Related Investment Measures (TRIMs); the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS); and the Agreement on Subsidies and Countervailing Measures (ASCM). In addition, there are international disciplines on capital movements. The most important disciplines are: the OECD Code of Liberalisation of Capital Movement and Current Invisible Operations[26] and the Articles of Agreement of the International Monetary Fund (IMF)[27]. The OECD Codes encompass legally binding rules to abolish restrictions on capital movement and current invisible transactions (mainly services). In addition, the Energy Charter Treaty provides a legal framework for international energy cooperation, including rules on investment protection and promotion.[28]

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[26] An up-dated text of the OECD Code of Liberalisation of Capital Movement (1961) is available at http://www.oecd.org/dataoecd/10/62/39664826.pdf.
An up-dated text of the OECD Code of Current Invisible Operations (1961) is available at http://www.oecd.org/dataoecd/41/21/2030182.pdf.

[27] See Articles of Agreement of the International Monetary Fund (1976), Article I(iv-v) and Article VIII, section2(a).

[28] All 27 EU member states as well as the EC are parties to the Treaty. See http://www.encharter.org/fileadmin/user_upload/document/Public_ratification_Treaty.pdf.

As a consequence of the fact that there is no multilateral investment agreement, there is no universal forum where investment issues could be discussed. Instead, several international organizations are working with different issues relating to investment. The WTO, the OECD and the IMF have already been mentioned above. The UNCTAD and the World Bank are among the most active international organizations in the field of investment. Both organizations focus on promotion of investment in developing countries, but also provide forums to discuss investment rules. UNCTAD has a very active investment unit which for example follows and reports the developments in the bilateral and regional investment agreements and the investor-state arbitrations. The World Bank houses the International Centre for Settlement of Investment Disputes (ICSID).[29] Indirectly, both the work of the UNCTAD and the World Bank affect the international investment rules.

The work of the WTO and the OECD is briefly presented below.

WTO

The EC, represented by the Commission, is negotiating improved market access for *establishment in services sectors* in the Doha Round.[30]

The 2001 Doha mandate to initiate new negotiations included rules on investment, provided that an explicit consensus so decided.[31] In 2004, the WTO General Council decided that negotiations of rules on investment would not be initiated under the Doha Round.[32] As a consequence, there are currently no negotiations for a multilateral framework on investment rules in the WTO.

OECD

The OECD has two sets of instruments regulating foreign direct investment: the Codes of Liberalisation, mentioned above, and the National Treatment Instrument[33]. The latter is not legally binding but encourages adhering countries to give foreign investors no less favorable treatment than domestic investors. All instruments are continuously reviewed in order to achieve improvements in the countries' commitments. The EU member states actively participate in the OECD work on investment. The EC, represented by the Commission, is also participating in the committees. Although there is a certain degree of coordination within the EU-group, the Union does not speak with "one voice" in the OECD.

Among the work conducted by the OECD, the following two are of particular interest: the round-table on "Freedom of Investment" (including

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[29] ICSID is established by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. To date, over 140 states have ratified the Convention. The ICSID Convention, Rules and Regulations are available at http://icsid.worldbank.org/ICSID/ICSID/RulesMain.jsp.
[30] See our paper on services in this series at www.kommers.se/trade&growth.
[31] WTO (2001), para 20.
[32] WTO (2004), page 3.

foreseen work on developing guidelines on Sovereign Wealth Funds for recipient countries); and the work with developing the "Policy Framework for Investment". These projects aim to foster an open global investment regime and to ensure the respect of the core principles embedded in OECD's instruments: predictability; transparency; and proportionality.

In 1995, the OECD opened negotiations on a Multilateral Investment Agreement (MAI). The negotiations broke down in 1998 and have not been resumed since.[34]

2.3.2 Regional and Bilateral Investment Negotiations

In the absence of a multilateral investment agreement, it has become more and more common to regulate investment liberalization and protection through bilateral and regional agreements. The amount of bilateral and regional agreements has grown considerably since the beginning of the 1990s. At the end of 2006, 2 573 bilateral investment treaties (BITs) and 241 preferential trade and investment agreement have been concluded.[35] The EU member states are parties to approximately 50 % of the total BITs.[36] Under these bilateral and regional agreements, a large number of arbitrations between investors and states have taken place. Between 1987 and 2007, around 290 known investment treaty arbitrations took place. In 2007, 35 known investor-state cases were filed under an international investment agreement.[37] Investor-state arbitrations take place either in ICSID or in *ad hoc* panels. The level of transparency is very poor.[38]

Market access for *establishments in services sectors* is included in the EC's free trade agreements with Mexico and Chile as well as in the recently concluded economic partnership agreement with Cariforum. Market access for establishments in other sectors than services sectors (i.e. manufacturing industry) is also included in the agreement with Chile and with Cariforum. As mentioned above, the EC and all 27 EU member states are also parties to the Energy Charter Treaty.

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[33]The National Treatment Instrument consists of two elements: a declaration which forms part of the Declaration on International Investment and Multilateral Enterprises (1976) and an OECD Council Decision, which obliges adhering countries to notify their exceptions to national treatment (last amended in 1991). The documents are available at http://www.oecd.org/document/48/0,3343,en_2649_34887_1932976_1_1_1_1,00.html.

[34] For an in-depth discussion of the MAI, see for example Henderson D. (1999), UNCTAD (1999) and OECD(1998a,b).

[35] UNCTAD (2007).

[36] At the end of 2005, the EU-25 had concluded 1272 BITs. In addition, Romania and Bulgaria had concluded a total of 148 BITs. See UNCTAD (2006), statistical annex - *Accumulation of Bilateral Investment Treaties*.

[37] UNCTAD (2008).

[38] For an in-depth discussion of the investor-state arbitrations, see for example Franck, S.D.(2007).

In November 2006, the EU member states agreed to the final text of the "Minimum Platform on Investment for EU FTAs". The objective of the minimum platform on investment is to strengthen EC enterprises access to foreign markets. Consequently, the text focuses on provisions of non-discriminatory market access. The agreement with Cariforum is the first agreement that adopted the new approach.

In addition, EU member states individually negotiate and conclude BITs for promotion and protection of investments. The purpose of the BITs is foremost to create legal certainty for investors outside of their home-country. For this purpose, the focus of the agreements is on non-discrimination of foreign investors and implementation of non-discrimination provisions (i.e. settlement of disputes).

Most often, European BITs focus on the following components:

- Non-discrimination of foreign investors
  - Relative rights: No less favorable treatment than national investors (*national treatment*) or investors from other countries (*most-favored-nation treatment*)
  - Absolute rights: Fair and equitable treatment of foreign investors
- Free transfer of capital
- Subrogation of rights
- Compensation for expropriation
- Settlement of disputes
  - State-state disputes
  - Investor-state disputes

All 27 EU member states have concluded BITs, although the amount of agreements varies from country to country. At the end of 2005, two EU Member States had concluded over 100 agreements and five member states had fewer than 40 agreements. The remaining majority had concluded between 40 and 100 agreements.[39] There are also intra EU-BITs (i.e. BITs between EU member states).

As mentioned above, a large number of investor-state arbitrations have taken place under the BITs. Although the arbitrations are solutions to individual disputes, they affect the landscape of international investment rules as government negotiators consider them in negotiations for new BITs. Both EU member states and companies from the EU have been parties to investor-state disputes.

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[39] UNCTAD (2006), statistical annex - *Accumulation of Bilateral Investment Treaties*.

3 Proposal - A Common Investment Policy for the EU

3.1 Problem Description

The current regulation of investments in the EU is heterogeneous and contains several discrepancies which originate from the division of competence between the EU member states and the EC. This has resulted in different levels of protection for EU investors abroad (legal as well as financial) and moreover a non-transparent patchwork of EU member states BITs. At the end of 2005, the EU-25 had concluded 1272 BITs. In addition, Romania and Bulgaria had concluded a total of 148 BITs. This constitutes approximately 50 % of the total BITs in the world. The division of competence has also led to that the regulation of capital movements varies from member state to member state, resulting in discrepancies. As mentioned above in section 2.2, capital movements include transactions such as direct investments, investments in real estate and portfolio investments. EU member states are also competing with each other, through various investment incentives, to attract foreign investors.

Thus, the current situation prevents the EU from negotiating broad and in-depth investment agreements with its trading partners. This harms the EU as a whole as it creates distortions between EU member states and moreover reduces the market access for EU investors in third countries.

3.2 Proposal: A Common Investment Policy for the EU

We propose a common investment policy for the EU, which would improve the competitiveness of the EU as a whole through increased transparency and reduced asymmetries. In effect, a common investment policy would first, strengthen the market access and investment protection in third countries for EU investors and second, create an equal level playing field for foreign investors in the EU. Thus, it would strengthen the EU on the global arena, as it would increase the EU´s possibilities to conclude broad and in-depth international investment agreements.

In order to fulfill the goals of a common investment policy for the EU, as presented above, the following components should be included:

- EU competence to negotiate and conclude international investment agreements covering both market access and protection of investments
- Harmonization, at a lower level, of EU member states' restrictions on capital movements

EU competence to negotiate international investment agreements (EU BITs and preferential regional trade and investment agreements) should cover both market access (pre-establishment phase) and protection of investment (post-establishment phase). This would enable the EU to negotiate investment protection for all EU 27 member states. Consequently, the member states would no longer negotiate BITs. It also implies that, in the long run, the large number of EU member states' BITs would be replaced by EU BITs. It would also enable the EU to negotiating broad and in-depth investment agreements with its trading partners.

The restrictions on capital movements maintained by EU member states should be harmonized, at a lower level.[40] Currently, the levels of restrictions on investments – in terms of *equity* (limitations on foreign ownership), *screening* (e.g. review of foreign acquisitions), and *operational* (movement of key personnel) – vary between EU member states. This is a consequence of the fact that EU member states have been allowed to maintain restrictions which existed on 31 December 1993.

A common EU investment policy might also encompass other areas, such as investment guarantees and financial investment incentives.

Investment incentives encompass for example financial subsidies, tax grants, employment and infrastructure subsidies and research and development support. According to Article 87 of the EC Treaty, investment incentives are not allowed to distort trade between EU member states.[41] The EC has already some competence concerning financial incentives. These are, however, mainly limited to financial aid to small and medium-sized enterprises.[42]

Under an investment guarantee system, an investor is compensated for damages abroad. Currently, many EU member states maintain investment guarantee systems. Common rules and/or coordination of the domestic investment guarantee systems could be a part of the common investment policy for the EU.

3.3 Procedure

When the Lisbon Treaty comes into force, the EU Common Commercial Policy will be extended to FDI. This will facilitate the creation of a common EU investment policy. With a wide interpretation of Article 188C of the Lisbon Treaty, the EU will be able to conclude broad and in-depth investment agreements, covering both market access (pre-establishment phase) and protection of investment (post-establishment phase). A wide interpretation would also give the EU competence in the areas of financial investment incentives and investment guarantees.

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[40] This ensures that the harmonization would not result in a higher level of restrictions.
[41] Exceptions can, however, be found in Article 87.3 of the EC Treaty.
[42] See for example Articles 160 (concerning the European Regional Development Fund), 166 (EU support of research and technological development activities), and 267 (European Investment Bank) of the EC Treaty.

Article 57(2) of the EC Treaty empowers the Council to adopt measures on the movement on capital to and from third countries. Under this article, harmonization of the EU member states investment regimes could be achieved.

3.4 Motivation

A common EU investment policy would generate several benefits which would improve the competitiveness of the EU, as a whole, and strengthen the EU on the global arena.

Increased policy coherence

Extending the EU Common Commercial Policy would, in effect, create policy coherence on promotion and protection of EU investments in third countries, and vice versa. This harmonization would first and foremost reduce asymmetries and uncertainties as the policies on investments would become more transparent, which is important not only for the EU member states but also for third countries wishing to promote investments.

In detail, the EU competence on investment would reduce distortions between EU investors in third countries through replacing the existing EU member states BITs with EU BITs. This would remedy the issue in which a few EU member states have a comparative advantage, compared to other EU member states, through their magnitude of negotiated BITs which enables them better protection in third countries. It would further improve the transparency at the global level, as the total number of BITs would be reduced significantly. Increased transparency is especially important for EU's small and medium sized enterprises (SMEs). The reason is that SMEs lack the resources to navigate in a more complex setting, as compared to large MNEs.[43]

Investment guarantees could be included in a common EU investment policy in order to ensure an equal level playing field for European investors abroad. The same reasoning can be applied on financial investment incentives, in relation to EU member states.

[43] This argument can also be applied to non-EU SMEs

Increased attractiveness of the EU as a location for FDI

A common EU investment policy would further increase the attractiveness of the EU as a location for FDI from third countries, since a harmonized investment scheme on an EU level would create an equal level playing field for foreign investors in the EU.[44] Studies show that economies with more transparent trade and FDI regimes attract more FDI compared to those economies with less transparent trade and FDI regimes.[45] The explanation is that uncertainties and non-transparent policies impose additional costs on businesses and increase the firm's costs, which in essence lowers the incentive to invest.

Increased bargaining power and efficiency gains

A common EU investment policy would also strengthen the bargaining power of the EU. This fact can be exemplified by the conclusion of BITs, as the negotiating power of the EU altogether would be much stronger than those of individual EU member states, especially the smaller states. In effect, it would increase the probability for more favorable conditions for EU investors in third countries. It would further bring about significant efficiency gains as the internal decision making process within the EU would be simplified.

With a common EU investment policy, the EU could conclude broad and in-depth investment agreements, covering both market access (pre-establishment phase) and protection of investment (post-establishment phase).

As trade and investment complement each other in numerous ways, the EU common commercial policy, comprising both trade and FDI, would further bring about a closer link between trade and investment policies. More explicitly, a combined and consistent approach in both areas would facilitate the conclusion of international agreements on trade and investment, relevant for the competitiveness of the EU.

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[44] Ideally, third country investors should be protected in all EU member states simultaneously and EU member states' restrictions on capital movements should be harmonized.

[45] Drabek and Payne (1999).

4 For the Future - A Global Investment Agreement

4.1 Problem Description

Investments are presently regulated through both multilateral instruments and numerous bilateral and regional agreements. As mentioned earlier, the number of bilateral and regional agreements has grown considerably during the last decade. At the end of 2006, 2573 BITs and 241 preferential trade and investment agreements had been concluded.[46] Many of these agreements have much in common and to some degree complement each other as they cover a broad set of issues, trying to ensure transparency, stability, market access and investment protection by eliminating barriers and discrimination. However, even though the current agreements are of great importance for FDI and the activities by MNEs, they are nevertheless a patchwork of bilateral, regional and multilateral agreements that contains overlaps, gaps and inconsistencies.

In sum, the current rules bring about discrepancies, uncertainties and non-transparent investor-state arbitrations, which will continue to increase as the globalization process becomes ever more complex.[47] This is suboptimal as is hinders investors to expand internationally, maximize profits and improve their competitiveness.

4.2 A Global Investment Agreement

The thought of a global investment agreement is not new. In the past, several initiatives have been taken to reach such an agreement with the aim to create a transparent, predictable, stable and non-discriminatory global investment climate. The initiatives have also aspired to increase market access and facilitate increased flows of FDI.

A future global investment agreement could encompass: national treatment and most-favored nation treatment (covering all phases of the investment process); a formal dispute settlement mechanism (covering both state-state disputes and investor-state disputes); a wide definition of "investment" (including direct investments and portfolio investments, intellectual property, real estate, rights under contract and rights conferred by authorizations or permits); and standards of investment protection (e.g. relating to general treatment, expropriation, protection from strife, and free transfer of funds.

[46] UNCTAD (2007).
[47] As mentioned earlier in section 2, between 1987 and 2007, approximately 290 known investment treaty arbitrations took place, and in 2007, 35 known investor-state cases were filed under an international investment agreement.

The components above can be found in existing bilateral and regional investments agreements, with varying depth in commitments. The elements above can be seen as a minimum in order to replace the large number of existing bilateral and regional investment agreements.

4.3 Motivation

A future global investment agreement would generate similar benefits as the proposal on a common investment policy for the EU, although in a broader international context.

Building on previous work, the reasons for a multilateral framework remain, by and large, the same. It can even be argued that against the background of the increasing number of regional and bilateral investment agreements and thereto related investment disputes, the reasons are even stronger today than they were ten years ago.[48]

An increasing number of developing countries are nowadays not only the host to inward FDI but also the source to FDI, as an increasing number of countries have emerged and integrated into the world economy. This fact calls upon the need for a global framework of investment rules to secure a fair competition worldwide, to enable greater market access and at the same time safeguarding the investment rights.

Between 1998 and 2005 about 900 additional BITs were concluded. This constitutes an increase by approximately 50 % of the total BITs in the world. At the end of 2005, developing countries were party to 75% of all BITs and further concluded 26 % of all BITs between themselves. This underlines the fact that an increasing number of countries can be seen as stakeholders in favor for a global investment agreement, as they have more to gain today compared to ten years ago.

As an increasing number of countries have emerged on the global arena, more countries would be able to reap the benefits from a global investment dispute settlement mechanism. This mechanism should address the lack of transparency currently surrounding the investor-state investment arbitrations.

[48] See OECD (2002).

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